



# The Real Estate ANALYST

APRIL 17  
1961

Volume XXX

Number 15

*As I sell*

## THE FUTURE OF RAW LAND

**D**URING the past few years, home builders have constantly complained of the rapid increases in the prices of raw land suitable for subdivision purposes. Many of them seem to think that we are running out of available close-in ground, and that the excess demand is forcing prices to a high scarcity level.

In the course of a year I fly in and out of many of the larger cities of the United States. The view from the air of any large city will disclose tremendous unbuilt areas that are not always so apparent from the ground. Is land really becoming scarce around our big cities?

My own opinion is that it is not. I think a great deal of land has been held off the market by speculators and long-term investors who know that its attractiveness will increase as the supply gradually decreases. Some of it in the meantime is being used for truck farms and for other similar purposes.

It is my opinion that the person who holds land idle from its highest and best use in a metropolitan area is doing a disservice to the community. In a free enterprise economy, however, he will probably continue to hold it off the market as long as he can as, with no effort on his part, this will yield greater profits than he could secure in alternate types of investments.

Part of the difficulty lies in the failure on the part of assessors to assess properties on the basis of fair market value rather than on use. Around many of our cities land used for truck gardening or for farming is assessed on a rather nominal basis, while adjoining land developed into subdivisions is assessed more nearly in relationship to its fair market value.

I have studied the assessing manuals of a great many of the various States, and practically all, with the exception of California, Florida, and Maryland, insist on all types of properties being assessed on the same basis -- that is, either at fair market value or at some standard percentage of fair market value. When an honest reassessment program takes place in an area where the assessor has not been following the manual and the State Constitution, the owners of much of this close-in land are up in arms, claiming that they are being driven from their land as they cannot secure enough income through farming or from other uses of their land to pay a return after paying taxes on the basis

on which their land is being assessed. I have heard the same complaint raised by a woman living in a single-family residence on a commercial street, where all of the properties around her were developed with sizable buildings. She maintained that to tax her property on the basis of what she could sell it for would drive her from her home.

I believe that it would and that it should. Her calamity is not too great, however, as the price she could get for her property exceeds its value as a residence by a great many times. She can sell and buy a comparable residential building for a small fraction of the selling price and can invest the balance to yield a sizable income. During the interim period she has used her real estate taxes on this property as a deduction on her income tax. When she sells the increased price is a capital gain, taxable at a far lower rate than regular income.

When property is assessed on the basis of use rather than on value, a discount is always given to the person who keeps his property from its logical use and thereby hurts the community and the area. I know of properties which, until a nonpolitical, disinterested program was instituted, paid less than one-tenth of the taxes they should on vacant ground. I know of properties assessed on the basis of \$450 an acre that should have been assessed on the basis of \$4,500 an acre.

In the following table I show the actual assessments and real estate taxes per acre of all vacant land sold in one assessment district of a large metropolitan county in 1959, and the assessments and the taxes on the same property if the rulings of the State Tax Commission had been followed. The biggest increase in taxes was from \$7.17 an acre to \$411.78 an acre. The smallest increase was from \$21.11 an acre to \$50.44 an acre. The average increase on the 15 parcels was from \$8.45 an acre to \$122.66 an acre. The average increase was  $14\frac{1}{2}$  times.

Parcel	ASSESSED VALUE PER ACRE		REAL ESTATE TAX PER ACRE	
	Was	Should Have Been	Was	Should Have Been
1	\$ 175	\$ 1,525	\$ 7.95	\$ 69.24
2	185	1,010	8.40	45.85
3	190	6,133	8.63	278.44
4	160	5,333	7.26	242.12
5	153	873	6.95	39.63
6	175	1,067	7.95	48.44
7	158	1,690	7.17	76.73
8	158	9,070	7.17	411.78
9	175	3,210	7.95	145.73
10	175	1,264	7.95	57.39
11	170	741	7.72	33.64
12	176	2,700	7.99	122.58
13	465	1,111	21.11	50.44
14	116	600	5.27	27.24
15	160	4,200	7.26	190.68
Total	\$2,791	\$40,527	\$126.73	\$1,839.93
Aver. per Acre	\$ 186	\$ 2,702	\$ 8.45	\$ 122.66

I doubt whether the average assessor will apply as literally the rulings of his State Tax Commission as this table would show, but it is clearly apparent that the general rule in this district was to tax vacant land at somewhere between \$5.25 and \$9.00 an acre, and apparently little judgment was used in differentiating between the low and the high.

It is one thing for a speculator to carry vacant land at an average cost per year of \$8.45 in taxes. It is another thing entirely to carry vacant land at an average of \$122.66 per year in taxes. Even if the assessor fails to follow literally the instructions of the State Tax Commission, I believe that the minimum tax would be about 10 times the old tax, and many a speculator would hesitate to hold land at this annual cost, even though his real estate taxes were deductible on his income taxes.

When vacant properties are assessed on the basis of fair market value, it becomes impossible to hold them for appreciation for a long period. The loss of interest on the money invested plus the annual tax cost of carrying, over a period of years, will frequently be greater than the appreciation in value.

A realistic tax policy of this sort will bring back on to the market a great deal of land which is not now for sale, and as more land comes on to the market, the high scarcity prices will have a tendency to drop.

I do not believe in the single tax of Henry George, as I think it is impossible to separate economic land value from the total value of a property which is developed to its highest and best use. I would agree with Ernest Fisher, that unimproved urban land can serve only limited uses, and that improvements are essential for use by any large number of persons. Once these improvements are made, however, the land and buildings become a joint product similar to a chemical compound in which the various elements no longer exist in their pure state. In chemistry there is quite a difference between a compound and a mixture. Silver nitrate is no longer silver, nitrogen and oxygen. It is a new substance having practically none of the characteristics of the three elements which went into its composition.

In spite of the nomenclatures and practices of appraisers, I maintain that it is impossible to arrive at a meaningful figure on the value of improved land apart from the improvements which have been put on it. These improvements are long-lived, and as they continue the ground cannot be treated as if it were vacant and available for some substitute use. A residence built on a 170-foot front placed in the center of the lot in an area where the average house occupies a 100-foot frontage has destroyed for at least 50 years the possibility of using the land it occupied in such a way that it will have the maximum value. Any appraiser appraising this property will of necessity have to reduce the value of the lot per front foot on the basis of excess frontage, as the extra frontage has not added as much to the value of the improved property as its cost. For at least the next 50 years the land and building involved in this illustration have become a compound that cannot be separated into its original elements without destroying a large part of the value of the joint product, or, in the case

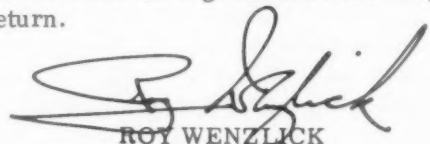
of extremely high-priced land, the improvements would be totally depreciated. Silver nitrate can be reduced to metallic silver, but only by destroying all of the characteristics of the compound in question. The simplest method of reducing silver nitrate to metallic silver is through the application of intense heat. The same method will reduce a piece of improved real estate to land value only. All of the books on appraising to the contrary, I know of no method of determining the value of the land alone in a piece of heavily improved real estate.

It would be difficult to prove that farm land on the edge of a built-up area could be used to far greater advantage by the community as a farm than it could if developed for urban uses. There certainly is an excess of fertile usable farm land in the United States. With modern machinery, fertilizers, and weed-icides, we have found it necessary to withdraw land from production and to limit the amount which can be grown on the remainder. Even then our farm surpluses have accumulated as the supply has exceeded the demand.

The continued operation of a farm in a metropolitan area can disrupt the orderly development of the metropolitan area, causing developers to skip over this land and to develop areas beyond it. This increases the cost to the area of maintaining water mains, sewers, streets, and transportation lines. It causes workers to travel longer distances than would otherwise be necessary.

In my opinion, assessing farm land on the basis of actual use rather than market value does not help the farmer. The experience in the States in which this is practiced has been that a large part of this land is bought by speculators and is then rented to farmers as a tax dodge. The speculator attempts to get enough income from the farm to pay the taxes on the property, with the assurance that without any activity on his part he will eventually reap capital gain on the value of the property. If the tax cost is low, land of this sort can be held for many years. I know of one truck farm which was operated on this basis for a period of 40 years well inside the city limits of the central city of a large metropolitan area. The income from the truck farm paid the taxes. In the meantime, the development of the surrounding city constantly increased the market value of the ground.

There is no more justification for assessing farm lands in a metropolitan area on the basis of actual use, ignoring the market price of the land, than there is for assessing office buildings and industrial plants at a different ratio than single-family residences. Most of the State Constitutions draw no distinctions between taxpayers. If property is being assessed at, say, one-third of market value, that should hold regardless of the use of the property. Office buildings, industrial plants, multifamily developments, and single-family residences should all be taxed on the same basis. Only when this is true will economic pressures force the development of land for its highest and best use, that is, the use which will pay the highest return.



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